

**Testimony of Susan Esserman  
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U.S. Trade Representative**

**Renewal of MFN Tariff Status for China  
House Ways and Means Committee**

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Thank you, Mr. Chairman, for calling this hearing and inviting the Administration's comments on China's Most Favored Nation tariff status.

**ENGAGEMENT WITH CHINA**

On June 3rd, President Clinton sent to Congress the formal waiver recommending extension of Most Favored Nation tariff status for China. This status is the foundation of a broad strategy of engagement on the full range of issues, based on the President's judgment of the national interest of the United States.

China's evolution in the next decades is profoundly important to the American people. As the world's most populous country and fastest-growing major economy, China will play a crucial role in the major international issues our country must address in the decades to come. The United States interest in these issues is best served by a secure, stable and open China. The President believes, as have all Presidents since Richard Nixon, that we can best guarantee the evolution of a secure, stable and open China through comprehensive engagement.

Engagement does not mean endorsement of Chinese policies. It is, instead, the best way to further our interests across the range of issues China policy must address. As the President noted last week, these include security in Korea and the four-party talks; a united international approach to the nuclear tests in South Asia; controls on proliferation of nuclear, chemical and biological weapons and ballistic missiles; international crime and drug trafficking; pollution and climate change; human rights; religious freedom; and trade and prosperity.

**MFN STATUS**

A fundamental part of engagement is normal trade relations, or Most Favored Nation tariff status. "MFN," of course, is a misnomer. It is the standard tariff treatment we accord virtually all our trade partners, and the foundation of our commercial relationship with China. MFN status was granted to China in 1980, shortly after the signature of our commercial agreement in 1979, and has been renewed by every President, every year, ever since.

Renewal of MFN is in our economic interest. Since 1980, exports to China have grown from an insignificant level to \$12.8 billion. China has become our sixth largest agricultural market. And together, exports to China and Hong Kong now support over 400,000 American

jobs.

It is also in our broader strategic interest. One example is China's response to the Asian financial crisis. Trade has given China a stake in economic stability beyond its borders. This has led China, for reasons of its own national interest, to contribute to the IMF recovery packages for Thailand and Indonesia; and still more important, to resist pressure to devalue its currency.

And it serves American values as well as interests. Computers, fax machines, television satellites, cell phones, books, music and movies are more than goods and services crossing oceans and borders -- they are the exchange of ideas and values. They already allow Chinese university students to debate US-China relations and economic reform on university bulletin boards, contributing to grass-roots inquiry and debate. And trade agreements themselves are expressions of broader international values: transparency, peaceful settlement of disputes, limits on the arbitrary power of the state, and the rule of law.

### **EFFECTS OF REVOKING MFN STATUS: TRADE**

With respect to trade, the effects of revoking MFN status would be severe. To revoke MFN, would, in fact, amount to the severing of our trade relationship.

Technically, revoking MFN would raise tariffs on Chinese products from approximately 6% today to a trade-weighted average of 44%. This would make American consumers pay approximately \$590 million more each year for goods such as shoes, clothing and small appliances. Manufacturers would see the cost of goods made with Chinese components rise sharply, reducing the competitiveness of our goods in domestic and international markets.

China would likely retaliate against US exports by increasing tariffs and other measures. This would endanger not only direct goods exports valued at \$12.8 billion last year, but a significant part of our \$15 billion in exports to Hong Kong. This would threaten the jobs of manufacturing workers, the income of farmers, the employment of young workers in retailing, software engineers and workers in every other walk of life. Their jobs and the export opportunities of their employers would go to Japan, Europe and other competitors.

Revoking MFN status would also derail our bilateral and multilateral negotiations. China could, for example, reduce or end its efforts to enforce our intellectual property agreements, reversing our successful effort to build an infrastructure of laws and law enforcement in this crucial field. And negotiation on WTO accession would stop, creating uncertainty about the future evolution of China's markets.

### **EFFECTS OF REVOKING MFN STATUS: BROADER ISSUES**

And the effects of revoking MFN would go well beyond trade. Let me mention three areas of strategic concern to the United States.

First, revoking MFN would likely endanger cooperation with China in areas outside trade. It would call into question our recently developed good working relationship against drugs and international crime. It would make progress on human rights, as symbolized by the recent release of several well-known Chinese dissidents, very difficult or even impossible. And it could threaten cooperation in national security questions such as the four-party talks on Korea, nuclear testing and proliferation and elsewhere.

Second, revoking MFN status would badly damage Hong Kong. Hong Kong's economy is based on trade and services. Fifty percent of US-China trade goes through its port. MFN revocation would seriously disrupt that trade, lead to uncertainty among the Hong Kong people, and lessen the international business community's confidence in Hong Kong as a trade and financial center.

Hong Kong authorities estimate that MFN revocation would slash its trade volume by up to \$34 billion, and income by \$4.5 billion. This would come at the worst possible time, as Hong Kong's growth has slowed and its unemployment rate is at a fifteen-year high; and just after it has conducted its first election as the Hong Kong Special Administrative Region, with the highest voter turnout ever in any Hong Kong election. That is why all leading Hong Kong figures, including Chief Executive C.H. Tung, Civil Service Chief Secretary Anson Chan, and Democratic Party leader Martin Lee, support China's MFN status.

And third, revoking MFN status would deal a severe blow to our larger efforts to solve the Asian financial crisis. This already affects our own economy, as we can see through a drop in exports to the Asian region, layoffs at companies which export to Asia, and instability in our own financial and stock markets. The stability of the Chinese economy during this difficult period, and the efforts of both the central Chinese government and the government of Hong Kong to avoid devaluing their currencies, have helped to prevent further deterioration. And a disruption of the magnitude of revoking MFN status would introduce new financial and economic instability to Asia, with unpredictable but likely very negative effects in the region and on the American economy.

Altogether, the vote on MFN is not an endorsement of Chinese policies, but on protection of fundamental U.S. interests. The Administration thus strongly supports renewal of MFN status.

## **US-CHINA TRADE RELATIONS**

Again, however, neither MFN status nor the broader policy of engagement means endorsement of Chinese policies. That is true in trade as in other areas.

With MFN status as the foundation, our trade relationship with China has large potential. Today China's economy is among the largest in the world, and the growth of such leading American industries as telecommunications, aviation, the services trades and professions, high-tech manufacturing and agriculture depend in part on access to China.

Significant problems remain in this relationship. The best means of addressing them is to use all the tools at our disposal, including our own trade laws, bilateral negotiations, regional talks and the multilateral system. And that is the approach we take under the engagement policy.

The \$75.4 billion in bilateral US-China trade last year represents \$62.6 billion in goods imports from China and \$12.8 billion in goods exports from the United States to China. Service export figures are not yet available for 1997, but are quite small; in 1996 we exported \$3.1 billion in services to China while importing \$2.0 billion, resulting in a small surplus. The total trade deficit -- nearly \$50 billion in 1997 and still growing this year -- has many causes, most important among them the strength of the U.S. economy. But trade barriers are a factor.

China restricts imports through means including high tariffs and taxes, non-tariff measures, limitations on which enterprises can import, and other barriers. The result is a pervasive and multilayered web of trade barriers in China. Due to limitations of space and time, I will cite only some of the major types of obstacles we have identified in China. They fall into two main areas.

The first are broad structural impediments. These include transparency, where while we have seen improvements, publication of laws and regulations is still incomplete, and sometimes offset by opaque customs procedures, administrative guidance and other procedures. Another is trading rights, where China restricts the right of individuals and companies to import and export. State-owned enterprises produce about 40% of China's industrial output, producing subsidies and conflicts of interest for government bodies which both own and regulate enterprises. And government procurement presents a large set of issues, beginning with the fact that China has no laws or regulations on the subject.

The second area is that of more formal and familiar trade barriers. Tariffs, though reduced from an average of 42.1% in 1992 to 17%, remain very high and particularly high in sectors which China has targeted for industrial policy, like chemicals and some motor vehicles. Non-tariff measures include non-transparent and WTO-inconsistent import licensing, quotas and other barriers. China's market for services remains essentially closed. Agricultural tariffs remain very high, and in cases like meat can be prohibitive. China's phytosanitary and veterinary import quarantine standards may not be based on science, unevenly applied and not backed up by modern laboratory testing techniques.

We have used all available tools, including our own trade laws and bilateral talks as well as regional negotiations and multilateral fora, to address these market access restrictions and establish predictable and fair rules. The bilateral agreements we reach, and vigilant monitoring and enforcement of these agreements, continue to be an important means to address specific sectoral problems. The Administration has been willing to threaten or impose sanctions when necessary to achieve its objectives, as was the case on intellectual property rights and textiles. Let me discuss each of these.

## **U.S. TRADE POLICY: THE CASE OF INTELLECTUAL PROPERTY RIGHTS**

In the past, pirated works and US brand names have been common in China. Since our IPR Agreement in 1996, however, the scale of piracy has been significantly reduced. In 1995, American copyright firms reported losses of over \$2 billion from piracy of software, CDS and CD-ROMs, books, audio and videocassettes in China. They faced further losses in third markets, as Chinese pirates began to export their product. Long and intense negotiations won agreements in 1995 and 1996 committing China to pass and enforce copyright, patent and trademark laws and shut down pirate operations. Since then:

- China has closed over 64 CD and CD-ROM production lines and the Chinese have destroyed the masters and molds being used to produce these products.
- China has arrested more than 800 people for IPR piracy.
- China has seized more than fifteen million pirated CDS and CD-ROMs, including those illegally smuggled into China.
- China issued 114,000 patents and 121,000 trademarks in 1997, many of which went to U.S. companies.
- Just this week, the government of Guangdong Province announced that it had seized and destroyed 2.8 million pirate video compact discs. Guangzhou has been one of the key transit points for VCDs smuggled into mainland China from Hong Kong and Macao.

This does not mean our work is at an end. Pirated retail CDS, CD-ROMs, and VCRs remain available in some Chinese cities. Chinese Customs and local anti-piracy officials must be more vigilant in enforcement. Illegal use of software in Chinese government ministries is a problem, and we are urging the Government of China to issue a State Council Directive prohibiting unauthorized software use. Protection of well-known trademarks is inadequate in China, and trademark counterfeiting remains widespread. And while the 1992 bilateral agreement permits U.S. pharmaceutical companies to obtain up to seven years of “marketing exclusivity” for products still under patent in the United States, China’s Ministry of Public Health may be violating the agreement by granting overly broad marketing approvals to competing Chinese pharmaceutical companies as U.S. applications for marketing exclusivity are pending.

We also have concerns about protection of intellectual property rights in Hong Kong and Macau. This year we noted an increase in piracy in Hong Kong, and placed Macau on the Priority Watch List of our annual Special 301 report. An IPR team from our office is working with Hong Kong and Macau, and both governments are taking steps to address our concerns.

## **U.S. TRADE POLICY: THE CASE OF TEXTILES**

Textiles are another example of success achieved through engagement.

In 1994, and in February of 1997, the Administration concluded bilateral agreements to achieve fair trade in textile products. In 1997, for the first time, our bilateral agreement provides for market access for U.S. textiles and apparel into China's market. China has also agreed to ensure that non-tariff barriers do not impede the achievement of real and effective market access for US textile and apparel exports. Following on cutbacks in China's textile quota growth rates under the 1994 agreement, the 1997 agreement further reduced the overall quota to address enforcement issues. China, having once been our largest source of apparel, is now our fourth.

Illegal transshipments of textiles from China has been a significant concern. We remain resolved to act against such imports. In 1994 and 1995, the Administration found and charged transshipped products against China's quotas. In 1996 we triple-charged China's quotas, and we did so again this year to account for such illegal transshipment. We will continue to be vigilant to prevent transshipment.

That said, we must note that the Chinese government appears to be making progress in preventing transshipment. Last year we detected less than \$2 million in illegal transshipments out of total Chinese textile exports of nearly \$6 billion.

### **BILATERAL PROBLEMS REMAIN**

We continue to work on these issues and a range of other bilateral problems.

In agriculture, China has not resolved sanitary and phytosanitary issues with respect to citrus, Pacific Northwest wheat and meat. And at times China has taken unpredictable measures which reverse our progress. Last October, for example, China raised the tariff on soybean oil to 20%, just as U.S. soybean oil products were entering world markets. Through quick action we were able to reverse this.

Earlier, China issued a decree requiring foreign financial information services to pay royalties to the Chinese government news agency. Again, we have prevented the implementation of this requirement.

And just last April, China announced an arbitrary ban on direct sales, intended to block scam schemes but also affecting well-regarded, law-abiding foreign operations. We are working with U.S. industry and Chinese authorities to address this issue.

### **PRINCIPLES OF WTO ACCESSION**

In addition to bilateral negotiations, China's accession to the World Trade Organization presents us with a comprehensive means to address the broad range of official and unofficial

barriers to the China market.

China's application to join the WTO is, of course, an historic event in itself. For decades, China -- together with Russia -- was one of the great antagonists of the principles the WTO embodies: open and transparent markets, the rule of law, and peaceful settlement of disputes. Thus the United States welcomes and supports China's application to join the WTO. However, we and other WTO members believe accession must be on commercially meaningful grounds.

The WTO is a contractual set of commitments, deepened continuously since the establishment of the GATT in 1948. These have developed from tariffs to include government procurement, standards, intellectual property, dispute settlement and more. And the sectors covered by the WTO have expanded from industrial goods to agriculture and services including basic telecommunications and financial services. All applicants, including China, must make commercially meaningful commitments in these areas.

### **STATUS OF WTO NEGOTIATIONS**

This is a daunting task. Our negotiations include basic WTO rules on non-discrimination, national treatment, transparency, judicial review, uniform application of laws, state trading, customs procedures and more. They address tariff rates on more than 6,000 individual tariff lines. They cover agriculture; industrial products including information technology; services; and nontariff measures including importing licensing and quotas. We will insist that accession be upon the merits.

But although daunting, our task is also achievable and we see some positive signs. We have won commitments from China to publish all its laws and regulations and give WTO members the opportunity to comment on them before they become effective. We have made progress on judicial review of administrative decisions. We have some good signs on trading rights and non-discrimination as well. In intellectual property, China has agreed to implement the WTO/TRIPS agreement upon accession. And on agriculture, China agreed not to use export subsidies.

And in market access, China has proposed to reduce the overall tariff level for industrial products. At the summit in Washington last October, President Jiang committed China to join the Information Technology Agreement (ITA), eliminating tariffs on all information technology products such as, computers, semiconductors, telecommunications and related equipment. Previously, China had refused to participate in any zero sector arrangement. And while we remain far apart on the services sector, we have entered detailed negotiations on distribution, professional services, audiovisual and financial and telecommunications services.

Much more work remains ahead in all areas. We have more to do on protocol issues and the working party report. We have more to do on tariffs. China's most recent written services offer did not sufficiently address U.S. requests in distribution, telecommunications, financial and professional services. Negotiations on agricultural market access have only just begun.

And China is not moving down the field toward a set of fixed global goalposts. China first indicated an interest in GATT membership in 1986. By 1994, as negotiations continued, we had completed the Uruguay Round, deepening coverage of agriculture, subsidies, government procurement, intellectual property; binding tariffs; and requiring binding dispute settlements. By the beginning of this year, the WTO had advanced through the Information Technology Agreement, the Agreement on Basic Telecommunications and the Financial Services Agreement. Next year we will open negotiations through the WTO's "built-in agenda" on agriculture, services, intellectual property and other issues as well. In the future lie talks on government procurement, bribery and corruption and other issues. The WTO is a single undertaking, and thus, the longer China delays making a commercially meaningful offer, the more comprehensive a commercially meaningful offer must become.

## **TRADE AND BROADER VALUES**

One final point. Trade policy, in its narrowest sense, is about access and fairness. Our negotiations and our discrete policy objectives focus on the details: tariff lines, copyright enforcement, phytosanitary inspections and so on. And our basic goal is fairness for American companies, workers, farmers and ranchers.

But the effects of trade policy will extend beyond commerce to fundamental national interests, values and ideals. We already see that in the contribution of our trade relationship to personal opportunity for Chinese citizens, the development of the rule of law in China, and China's growing stake in a stable, peaceful Pacific. In the future, the correct policy will help these healthy trends deepen and accelerate.

## **CONCLUSION**

And that brings me back to the broader point of engagement with China. Our discussions of China policy, including trade, concentrate on the problems. Rightly so. But on occasions like this hearing, we should also remember to step back and take the long view.

Just twenty years ago, when our trade relationship began, we did very little business in China. Very few Americans visited the country. Very few Chinese read foreign books, saw foreign news or traveled abroad. Few foreign firms -- indeed, few private businesses -- operated in China. And China remained among the world's most closed societies.

Today, with all the problems that remain, we see American business operating widely in China. American goods and brand names are available; and counterfeiters of those brand names are arrested and punished. The share of the state in the economy has fallen. The range of political debate has widened. And China is more open to the world than at any time since the Second World War.

These trends are not only good for China; they are good for America. And they show that



the engagement policy is working. To revoke MFN status would be to threaten all of them; and to threaten fundamental American interests as well. So again, the Administration strongly supports China's MFN status, and looks forward to working with the Committee to ensure its renewal this year.

Thank you, Mr. Chairman. I look forward to your questions and those of the Committee.